

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 02-12066

JACK L. HYLTON

Debtor

YVETTE GAFF KLEVEN, Trustee

Plaintiff

vs.

FIFTH THIRD BANK, et. al.

Defendants

PROC. NO. 04-1202

DECISION

At Fort Wayne, Indiana on December 7, 2005.

What looked to be a routine proceeding initiated by the trustee to determine which of several lienholders was entitled to the proceeds from a sale has, well over a year after being filed, yet to be resolved. In the interim, the sale proceeds have been deposited with the clerk pending the court's decision as to their distribution. Of the four lienholders named in the action, only Fifth Third Bank responded and it has consistently argued that, solely by virtue of being the only respondent, it is entitled to all of the money. By a decision dated March 29, 2005, the court disagreed with the argument that, by defaulting, the other lienholders had forfeited any interest they may have had in the sale proceeds and denied the trustee's motion to release those funds to the Bank. As the result of a subsequent status conference, a hearing was scheduled for October 24, 2005 in order to receive any evidence and arguments the parties might wish to present. The matter is before the court for a decision following that hearing.

At the hearing of the 24th, neither the Bank nor the trustee offered any evidence. Counsel for the Bank renewed its argument that, as the only defendant to respond, it is entitled to the sale proceeds, relying upon an Indiana decision, Centex Home Equity Corp. v. Robinson, 776 N.E.2d 935 (Ind. App. 2002), to support the argument. In Centex, the senior and junior mortgagees each instituted separate foreclosure actions involving the same property and each action proceeded independently from the other. The senior mortgagee was defaulted in the junior mortgagee's action and, at the resulting sheriff's sale, the property was purchased by a third party. Eight months later, the senior mortgagee obtained a judgment of foreclosure in its own proceeding and it was the successful purchaser at the subsequent sheriff's sale. The individual who had purchased the property at the earlier sheriff's sale then filed motions in both actions to have the judgments and the sales set aside. In the action brought by the senior mortgagee – the action in which the senior mortgage holder had purchased the property – the motion was denied and no appeal was taken. In the junior mortgagee's action, however – the one in which the property was sold to the third party – the motion was granted and the junior mortgagee appealed. It was in the context of this appeal by the junior mortgagee that the state court commented upon the effect of the senior mortgagee's default in that proceeding. Relying upon O'Brien v. Moffitt, 33 N.E. 616 (Ind. 1893), the Indiana Court of Appeals stated that by defaulting in the junior mortgagee's action the senior mortgagee had forfeited any interest it might have had in the mortgaged property.¹ Centex, 776 N.E.2d at 948. The Bank

¹This court previously noted that O'Brien was not about forfeitures or the rules of pleading but about the effect of a judgment that had been entered following some kind of default. Decision and Order on Motion to Release Funds, March 29, 2005, p. 2. It strikes the court that there is a significant difference between deciding what the effect of a particular judgment might be after it has been entered and deciding whether to enter that judgment in the first place. It is the latter inquiry that is before the court.

argues that the same principle should be applied here and, since all of the other defendants have defaulted, it is entitled to all the sale proceeds without regard to any other consideration.

The court must acknowledge that the Bank's counsel has correctly characterized the statements made by the Centex court. Nonetheless, there are legitimate reasons to wonder if that court truly meant what it said regarding the effect of the senior mortgagee's default, whether the ultimate holding of the decision actually stands for that proposition, and whether the statements were simply dicta offered en route to deciding the matter on some other basis. To begin with, the senior mortgagee did not participate in the appeal and the issues on appeal do not seem to have turned on the effect of its default; so it appears that the court's comments on that point should be regarded as nothing more than dicta. U.S. v. Crawley, 837 F.2d 291, 292 (7th Cir. 1988). Furthermore, the court's ultimate conclusion was that the trial court had acted properly in setting aside the junior mortgagee's sheriff's sale, that decision was affirmed and the buyer's money was directed to be refunded. Centex, 776 N.E.2d at 949. Thus, the actual outcome of the appeal was that the senior mortgagee remained in possession of the property it had purchased at the sheriff's sale in its own foreclosure action – a rather odd result given that its interest was supposedly completely extinguished because of the default in the junior mortgagee's action. As a result, one should approach Centex's comments that a lienholder's default in a proceeding operates to extinguish its interest in the property with a degree of caution.

More significant than whether the statements in Centex are simply dicta or represent something more persuasive, is the fact that this case is pending in federal court. The effect of a party's default is a procedural issue. In federal court, procedural issues are governed by federal rather than state law. Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817 (1938); Hanna v. Plumer,

380 U.S. 460, 467, 85 S.Ct. 1136, 1141 (1965). Thus, even if does Centex represent a correct statement of Indiana law concerning the effect of a mortgagee's default, this court must look to federal law to determine the effect of the other defendants' defaults in this action.

As this court stated in its earlier decision in this case, a "default is nothing more than an admission of the well pleaded factual allegations contained in the complaint." Kleven v. Fifth Third Bank, Proc. No. 04-1202 (March 29, 2005) (citing Dundee Cement Co. v. Howard Pipe & Concrete Prod., 722 F.2d 1319, 1323 (7th Cir. 1983); Nishimatsu Constr. Co. Ltd. v. Houston Nat'l Bank, 515 F.2d 1200, 1206 (5th Cir. 1975)). It is not a confession of judgment and it does not mean that the defaulting party forfeits whatever rights it may have had. Rather, the default implicates the facts upon which the court's decision is to be based and the defaulting party's opportunity to controvert the facts as they have been alleged in the complaint. Yet, even after a default, the court's decision must still be based upon the facts presented to it – whether those facts are ones that are deemed to have been admitted because of a failure to answer, or are presented to the court as evidence in connection with the proceedings before it. See, In re Taylor, 289 B.R. 379, 382-83 (Bankr. N.D. Ind. 2003).

Given that no additional evidence was presented at the final hearing in this matter, the only facts the court has before it are the ones that come from the trustee's complaint. Insofar as they bear on the existence and priority of the various judicial liens, those facts, which have not been controverted, questioned, or challenged, are as follows:

1. The defendant Restoration Contractors, Inc. obtained its judgment against the debtor for \$1,839.80 on June 6, 2001.
2. The defendant Cendant Mortgage Corp. obtained its judgment against the debtor for \$85,718.69 on November 16, 2001.

3. The Bank obtained its judgment against the debtor for \$40,431.23 on December 19, 2001.
4. The defendant Libby Thompson obtained her judgment against the debtor for \$112.00 on November 14, 2002.

Each of these judgments created a lien upon the property sold as of the date it was entered, see, Ind. Code § 34-55-9-2 (2005), and that lien was transferred to the sale proceeds. Although there has been ample time to conduct discovery and to investigate the continued vitality of the liens arising out of these judgments, the court has not been given any information to suggest that any of the judgments have been satisfied, set aside or the resulting liens released. Thus, it has no reason to believe that the facts are other than those alleged in the complaint and no reason to enter judgment saying otherwise. Thus, of the \$3,513.46 deposited with the clerk of the court in this action:

1. Restoration Contractors, Inc. held the first judicial lien against the property sold and is entitled to receive the sum of \$1,839.80;
2. Cendant Mortgage Corp. held the second judicial lien against the property sold and is entitled to receive the sum of \$1,673.66; and,
3. Since the payments to the other defendants will exhaust the funds deposited with the court, neither Fifth Third Bank nor Libby Thompson, who held the third and fourth judicial liens against the property sold, are entitled to receive any payment.

Judgment will be entered accordingly.

/s/ Robert E. Grant
Judge, United States Bankruptcy Court